Retirement News for Employers

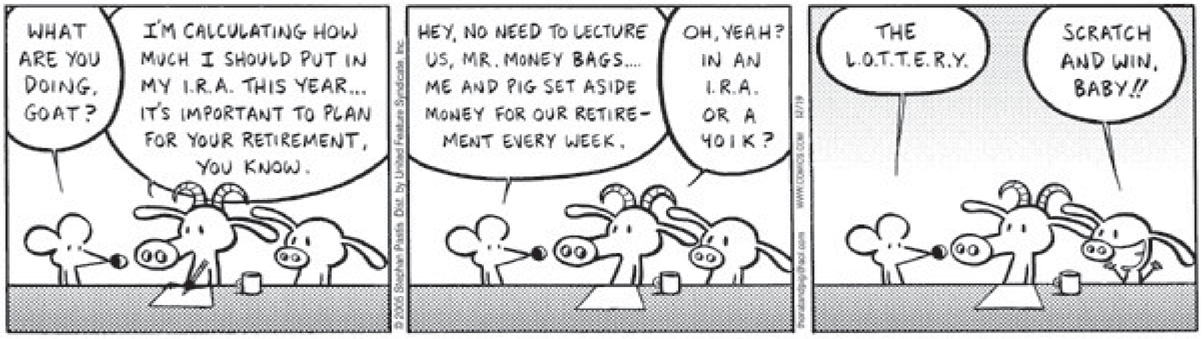
Helping Business Owners with Retirement Plans

Internal Revenue Service Tax Exempt and Government Entities

Volume 2, Winter 2006

Inside This Issue

Good For You…And good for your employees, too



If you're an employer and you're reading this newsletter, you probably already sponsor a retirement plan or you're considering it. If so, then we applaud you because:

- You're planning for your retirement;
- Your company gets tax deductions on plan contributions; and
- You're attracting – and retaining – valuable employees.

And a retirement plan is good for employees because:

- They're saving for retirement;
- They get tax-deferred growth on those savings;
- And so much more.

Now, it seems like every day there's another business "freezing" their traditional defined benefit plan. And it's not just bankrupt companies, news stories also describe financially healthy companies that are freezing their plans. Sometimes it's a "soft freeze" where new employees can't join the plan; other times it's a "hard freeze" where the company stops additional benefit accruals. Regardless of the financial health of a company or whether there's a soft or hard freeze, the result is the same: fewer people are earning retirement benefits at work.

Which brings us back to the title of this story: Good For You. By sponsoring a retirement plan, you're helping not only yourself but your employees as well. You may even be helping your country. Think about it for a moment: Where will retirees without adequate retirement savings go for help? Most likely, they'll head to the government…to the federal, state or local government.

So…if you are indeed providing a retirement plan – something other than a lottery pool at work – then: Good For You.

Note: *Thank you to* Stephan Pastis *and* UFS, Inc. *for granting permission to use the "Pearls Before Swine" strip of December 19, 2005.* ■

Product Profile – *SEP Retirement Plans for Small Businesses* Publication

Have you considered establishing a Simplified Employee Pension (SEP) plan for your small business? Does your small business sponsor a SEP? Do you have questions about some of the rules and requirements of your SEP? Well, there's a new publication that has the answers.

The IRS and U.S. Department of Labor's Employee Benefits Security Administration (EBSA) have jointly issued a publication to provide answers to your questions. *SEP Retirement Plans for Small Businesses* (Publication 4333) is a plain-language publication that provides you with basic information on establishing and operating SEPs, such as:

If you have any questions or comments about the cover story – or anything in the Retirement News for Employers *– please drop me, Todd Newman, a line at* RetirementPlanComments@irs.gov.

- Advantages of a SEP;
- Establishing the plan;
- Contributions to SEP-IRA accounts;
- Employee communications;
- Reporting to the government; and
- Distributions.

The publication provides an example of how a SEP works. In addition, it discusses the IRS and EBSA correction programs to help SEP plan sponsors correct plan errors, protect participants and keep the plan's tax benefits. Finally, the publication provides additional resources for your use if you need more in-depth information.

The publication, as well as additional information on SEPs, can be found on the Retirement Plans Community web page and the EBSA web site. Copies of the publication can be ordered by calling either (800) 829-3676 (IRS) or (866) 444-3272 (EBSA). Both numbers are toll-free. ■

Roth 401(k) Update

The IRS and Treasury have been busy, busy, busy! As we reported in the January 17 Special Edition, they released the much awaited Roth 401(k) final regulations on December 30, 2005. And now they've done it again: On January 26, they issued proposed regulations on designated Roth accounts. These proposed regulations are generally effective January 1, 2007 and they provide guidance on the taxation of distributions from designated Roth accounts and other related issues.

Important: Designated Roth contributions are allowed in 401(k) and 403(b) plans but they *are not allowed* in SARSEPs or SIMPLE IRA plans.

A designated Roth account is a separate account under a section 401(k) plan or section 403(b) plan to which designated Roth contributions are made, and for which separate accounting of contributions, gains, and losses is maintained. Effective January 1, 2006, a plan may permit an employee who makes elective contributions under a 401(k) or 403(b) plan to designate some or all of those contributions as designated Roth contributions. Designated Roth contributions are elective contributions that, unlike pre-tax elective contributions, are currently includible in gross income. However, a qualified distribution of designated Roth contributions is excludable from gross income.

Highlights of the proposed regulations include:

- Determination of 5-year period;
- Taxation of nonqualified distributions;
- Rollover of designated Roth contributions; and
- Reporting and recordkeeping.

For additional information on designated Roth accounts, see the final Roth 401(k) regulations, the proposed regulations and the updated Designated Roth Contributions FAQs featured in our Retirement Plans Community web page. ■

Critical FewPoints…by Michael Julianelle (Director, EP Examinations)

Hello again. I hope everyone's 2006 is off to a great start, both professionally and personally. As always, I welcome suggestions of topics you would like me to discuss in these pages. Please e-mail your suggestions to **RetirementPlansComments@irs.gov**. I will do my best to cover your ideas or concerns in future articles.

For this edition, I'll focus on some of the ways we are attempting to have examinations of your returns run much smoother, or avoiding the examination at all.

When I go to various conferences to speak about our efforts in Employee Plans Examinations, I get questions from the audience about the number of audits my agents can perform over time and if I'm concerned about not being able to audit more returns. My answer is: I would rather hire more employees who could provide an in-depth analysis of the return before it is considered for an examination. Having the resources to perform that function and focusing on taxpayer non-compliance based on analysis and historical information/data would lead to better case selection and better use of my resources, i.e., the agents. I don't wish to burden you with an examination if there is nothing worth pursuing and I don't wish to waste my resources in performing those types of audits. I want my agents to be examining returns that need to be examined. Of course, because I also believe in a vigorous Enforcement program, I would take those additional resources and focus them on non-compliant areas.

One way of saving both you and me time and resources is the establishment of the Employee Plans Compliance Unit (EPCU). EPCU is staffed with agents, analysts, statisticians and economists who will contact you or your representatives addressing items of potential non-compliance. A simple verification or question answered in lieu of an examination of the return will save you and me the money and resources discussed earlier. A special edition of our practitioner newsletter, ***Employee Plans News***, has an article about EPCU if you want to know more about their operation.

Another project currently in development involves the Third Party Administrators (TPAs) and Benefit Consultants many of you employ to maintain and administer your plans. As of now, many of these folks are not authorized to practice before the IRS. ACT would like to make changes to this prohibition.

ACT? What's ACT you say? ACT stands for the Advisory Committee on Tax Exempt and Government Entities, a group of benefits practitioners that provides a venue for public input into critical tax administration areas. ACT is an organized public forum for the IRS and representatives who deal with Employee Plans as well as the other areas in Tax Exempt and Government Entities. ACT allows IRS to receive regular input on administrative policy and procedures of the Tax Exempt and Government Entities Division. Members are appointed by the Secretary of the Treasury and serve two-year terms.

CONTACTING EMPLOYEE PLANS

The *Retirement News for Employers* welcomes your comments about this issue and/or your suggestions for future articles.

Send comments/suggestions to:

EP Customer Education & Outreach
SE:T:EP:CEO
1111 Constitution Avenue, N.W., PE-4C3
Washington, D.C. 20224

or FAX (202) 283-9525

or E-Mail: **RetirementPlanComments@irs.gov**

For **EP Taxpayer Assistance:**

For retirement plans technical and procedural questions:

Please call (877) 829-5500

Or visit the EP Customer Account Services section at **www.irs.gov/ep**.

For questions relating to retirement income, IRAs, Roth IRAs, educational IRAs, medical savings accounts and section 125 cafeteria plans:

Please call (800) 829-1040

For further **Employee Plans Information:** Go to **www.irs.gov/ep**.

OK, back to what they are doing…they want to establish a mechanism for increasing the accountability of these groups that assist you in the day-to-day running of your plan. The ACT Proposal recommends the establishment of the Enrolled Retirement Plan Agent (ERPA) category under Circular 230 to allow these currently "unenrolled" preparers limited practice before the IRS in the employee plans arena. The examination, enrollment, renewal procedures, and continuing education requirements of the enrolled agents currently allowed to practice and ERPAs will mirror each other to the extent possible. However, the scope of an ERPA to practice before the IRS will be limited to certain specific sections of the Internal Revenue Code relating to retirement plan matters. The ACT Proposal on ERPAs is included in the text of the **proposed Circular 230 rules**. This new program is in development, but I thought it was worthy to share with you in this column.

You can access information on EP's examination/enforcement results at **www.irs.gov/ep**.

Thank you for reading and be well. ■

How to Subscribe to *Retirement News for Employers*

The *Retirement News for Employers* is issued only through IRS e-mail. For your free subscription, please go to the Retirement Plans Community web page and subscribe online by selecting "Newsletters" under "Retirement Plans Community Topics." All editions of the *Retirement News for Employers* are archived there.

For your convenience, we have included Internet links to referenced materials throughout the *Retirement News for Employers*. These links are identified by blue and underlined text.

Net Gains

After a lengthy hiatus, please welcome back *Net Gains*, the column devoted to providing you with the latest **Retirement Plans Community web page** information. This portion of the **IRS web site** contains almost everything you want to know about retirement plans but didn't know where to find it.

For example, here are some recent additions to the **Retirement Plans Community web page**:

The 401(k) Plan Resource Guide

The ever-growing Retirement Plans Community web page has now added a **new resource guide** for 401(k) plan sponsors and plan participants. The guide is a one-stop shop for 401(k) plan information.

For plan sponsors, the guide provides information on:

- Overview of 401(k) plans;
- Starting up your plan;
- Plan qualification requirements;
- Filing requirements; and
- Other items.

For plan participants, the guide contains information regarding:

- Summary plan descriptions;
- Interested parties;
- Limitation on elective deferrals;
- General distribution rules; and
- Other items.

Is there something missing from here you would like to have added? Please contact us at **RetirementPlanComments@irs.gov**. This guide is here for you and we would like to make it as user-friendly as we can for you. Let us know your thoughts!

"Timing is Everything" Archive

In the Fall 2005 Edition of the *Retirement News for Employers*, we debuted the "Timing is Everything" flyer. Each one-page Timing flyer has plain-language retirement information for employees and plan participants. And as we promised, we've developed an archive of the Timing flyers on both the Plan Sponsor/Employer and Plan Participant/Employee sections on the Retirement Plans Community web page. And when you go to the online archive, you'll discover that the flyers have even more help to offer because we've provided links on each flyer that provide more details about specific retirement plans and products. As always, we welcome your suggestions about future Timing topics, so drop us a line at RetirementPlanComments@irs.gov.

Timing and More Timing

The second edition of our "Timing is Everything" flyer is on page 9. In this edition, we have info on IRA contributions – including still having time to make deductible contributions for 2005.

Feel free to go ahead and print and/or share the flyer with your employees.

Plan Participant/Employee Material

Now on the Retirement Plans Community web page, you can find retirement information designed and written for the Plan Participant/ Employee customer segment. Among the information topics you'll find are pubs and forms along with Frequently Asked Questions aimed at participants and employees. We'll continue adding to and improving the material we have. If you don't find what you're looking for, let us know at RetirementPlanComments@irs.gov and we'll get to it.

The Fix Is In: Common Plan Mistakes

In each issue of the *Retirement News for Employers* we present a common mistake that occurs in retirement plans. We describe the problem, how it happened, how to fix it and how to lessen the probability of the problem happening again. This edition of the column focuses on **"Excess Deferrals."**

The Issue

Many of you have a 401(k) plan which allows for elective deferrals. The law – the Internal Revenue Code – imposes a limit on the maximum elective deferrals that an employee can make each year to a qualified plan. This includes elective deferrals under 401(k) arrangements (including SIMPLE 401(k) and safe harbor 401(k) plans), 403(b) plans and SIMPLE IRAs. Making deferrals in excess of legal limits is one of the top 10 issues identified during examinations of 401(k) plans.

Remember that some deferrals can be characterized as "catch-up" contributions and are not subject to the general limitations that apply to a 401(k) plan.

The Problem

The elective deferral limit is a flat dollar amount that is subject to annual cost-of-living adjustments. The limit for traditional or safe-harbor 401(k) plans in 2005 was $14,000 and is $15,000 in 2006 with increased limits for participants age 50 or more (an additional $4,000 in 2005 and $5,000 in 2006 - known as "catch-up" contributions). Employees whose elective deferrals exceed the limit must report the excess as income on their tax returns for the calendar year the deferral was made and on their tax returns for the calendar year when the excess amounts are withdrawn. If elective deferrals, all from the same employer, exceed the limit, the plan is disqualified. The only way to correct the mistake, avoid double taxation and potential plan disqualification is to have the excess amount, plus earnings, refunded to the employee by the tax-filing deadline for the year in which the deferrals were made (for example, by April 15, 2006 for excess deferrals made during calendar-year 2005). In that case, the excess deferral need only be reported as taxable income for the year the deferral was made. Refunded earnings attributable to an excess deferral must also be reported as income; losses attributable to an excess deferral can reduce reported income in the refund year.

The deferral limit is applied on an aggregate basis to elective deferrals made under all plans maintained by an employer. The employer is responsible for determining whether a participant has excess deferrals under all the retirement plans it maintains. However, excess deferrals by a participant will not disqualify a plan if the excess is due to the aggregation of the participant's deferrals to a plan maintained by an unrelated employer. We also note that the entire plan, not just the section 401(k) arrangement, is disqualified for violation of the deferral limitation.

Unless excess deferrals are corrected, both the participant and the plan face repercussions:
- A participant with excess deferrals has federal income tax consequences.
- The plan has a qualification issue.

Common causes for elective deferral failures include the failure to monitor:

- limitations for each employee,
- limitations based on the calendar year, and
- employees who transfer between divisions/plans of the same employer.

In some cases the employer is not aware that the deferral limitations apply to the participant, rather than the plan. Sometimes, the plan year is other than the calendar year and deferrals are made based on plan year compensation. When testing for compliance, the administrator bases the limitation on the **plan** year deferrals, rather than deferrals made during the **calendar** year as required by the law. Violations also occur when the employer and/or plan administrator fail to monitor employees who transfer between divisions and plans of the same employer and allow participants to defer the maximum amount under each plan.

The Fix

As we said earlier, violation of the elective deferral limitation by the plan will cause a plan to become disqualified, resulting in adverse tax consequences to the employer and employees under the plan. Employers may get relief from these adverse consequences through the **Employee Plans Compliance Resolution System (EPCRS)** by correcting the failures. The Self-Correction Program (SCP) or Voluntary Correction Program (VCP) can be used to correct these mistakes. In order to fix the mistake under SCP, generally the mistake must be fixed within two years after the end of the plan year is which the failure occurred. Unless the failure can be classified as insignificant, VCP must be used after this time.

Under EPCRS, the plan may avoid disqualification, even though the plan has failed to correct excess deferrals by the April 15 deadline. The permitted correction method is distributing the excess deferral to the employee and reporting the amount as taxable income in the year of deferral and in the year distributed. Thus, if the corrective distribution is made later than the April 15 deadline, the employee will be subject to double taxation on the excess deferral. EPCRS does not provide relief from this double taxation.

Making Sure It Doesn't Happen Again

Employers need to ensure that they have a system in place to monitor salary deferrals for those employees who participate in more than one plan of the employer. Employers should work with plan administrators to ensure that the administrators have sufficient payroll information to verify the deferral limitations were satisfied. Employers may wish to remind plan participants that monitoring deferrals from multiple employers is the participant's responsibility.

However, keep in mind that, despite all of your good efforts, mistakes can happen. In that case, the IRS can help you correct the problem and retain the benefits of your qualified 401(k) retirement plan. ■

The Filing Cabinet

Forms – you can't live with them, you can't live without them. Just like you use forms when running your business – everything from spreadsheets to receipts to invoices – you also use forms when dealing with a retirement plan.

Since our last installment, the IRS is pleased to announce the revision of a popular publication, the release of a new one, and the scheduled update of yet another.

IRS employees contributing to this edition of the *Retirement News for Employers* are:

Evelyn DeWald, Larry Isaacs, Michael Julianelle, Peter McConkey, Todd Newman, Mark O'Donnell, Nancy Payne, Keith Ruprecht, John Schmidt, Brenda Smith-Custer, Susan Taylor, and Mikio Thomas

- The **Publication 575**, *Pension and Annuity Income*, has been revised for use in the preparation of 2005 individual tax returns. Pub 575 discusses the tax treatment of distributions you receive from pension and annuity plans and explains how to report the income on your federal income tax return.
- In response to the disasters of 2005, the **Publication 4492**, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma*, has been released. This new publication lists the disaster areas for each hurricane and explains which areas are eligible for administrative relief from the IRS. It also provides which areas receive special tax breaks under recently enacted provisions of the tax law. The publication provides information for individuals regarding how to claim unreimbursed losses, the tax-favored use of retirement savings, and new rules regarding charitable giving.
- Be on the lookout for the revised **Publication 560**, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*. Pub 560 discusses retirement plans you can set up and maintain for yourself and your employees. The publication will be available online within the week, with paper copies available by the end of March.

All of these publications, both new and revised are (or soon will be, in the case of Pub 560) available on the **Retirement Plans Community web page** by clicking on "EP Forms & Publications" under the "Retirement Plans Community Topics" section and can be ordered by calling (800) TAX-FORM (829-3676). ■

DOL News

The Department of Labor's Employee Benefits Security Administration (DOL/EBSA) announced new guidance, relief and tools to assist plan sponsors and practitioners in complying with ERISA. You can subscribe to **DOL/EBSA's web site** homepage as well as the **Compliance Assistance page** for notice of updates posted on the website.

Updated Exemptions: Transactions with Financial Institutions and Insurers

On February 3, 2006, DOL/EBSA published in the Federal Register amendments to two existing class exemptions that will permit plans to engage in securities and other transactions with a greater number of financial institutions and insurers, if certain conditions are met. ERISA generally prohibits plans from entering into transactions with plan fiduciaries and other related parties unless an exemption applies.

Under the amendments to Prohibited Transaction Exemption (PTE) 75-1, a plan may engage in certain transactions with broker-dealers, reporting dealers and banks that are plan fiduciaries as long as the institutions and their affiliates do not have investment authority over or provide investment advice with regard to the plan's assets involved in the transaction. DOL/EBSA also granted similar relief under PTE 84-24 for insurance agents and brokers, pension consultants and mutual fund principal underwriters to engage in transactions involving sales of insurance and mutual fund products and to receive related commissions.

The revised exemptions address consolidation in the financial services industry that has resulted in greater numbers of affiliations between financial institutions. One protection afforded by the exemptions is that the terms of the transactions are required to be as favorable to the plans as an arm's length transaction with an unrelated party would be.

The amendments to PTE 75-1 are retroactively effective to January 1, 1975. The amendments to PTE 84-24 are effective on the date of the publication in the Federal Register.

Guidance on Fiduciary Responsibilities Regarding Advice and other Services

On December 7, 2005, DOL/EBSA issued Advisory Opinion 2005-23A providing guidance on whether a financial consultant hired by a participant in a 404(c) plan to provide investment advice or management is a fiduciary and provides investment advice within the meaning of section 3(21) of ERISA when he advises the participant to take a withdrawal in order to invest the assets in an investment not available under the plan. The guidance also addresses whether the advisor engages in a prohibited transaction if the recommended investment pays an additional fee to the advisor. ■

Let's Just Take It One Three-Month Period at a Time

$ = contribution/ distribution

C = conference

F = file forms

Operating a retirement plan can be a time-consuming job. There are deadlines, not just for reports and forms but also for making contributions. There are conferences and seminars. And then there is information you need to give to participants.

So to help you navigate the retirement plan timeline, here is our month-by-month look at some of the important moments in the months to come. Please note that all of the filing dates below are for calendar-year plans - adjust the dates for non-calendar year plans:

C **February 17:** SWBA/IRS Plan Administrative Skills Workshop - Tulsa, OK

C **February 24:** SWBA/IRS Plan Administrative Skills Workshop - Houston, TX

C **March 10:** EBSA Choosing a Retirement Plan for Your Small Business Clients Seminar - Little Rock, Arkansas

F **March 15:** Deadline for -

- Submitting waiver requests for the 2005 plan year for single employer plans.
- Change in funding method requests for the 2005 plan year if a statement is attached detailing the reason for the delay.

$ **April 1:** Last day to make required minimum distributions - Code section 401(a)(9) requires that distributions begin no later than April 1 of the calendar year following the later of:

- The calendar year in which the employee attains age 70 ½ (required for 5% owners) or
- The calendar year in which the employee retires.

$ **April 15:** First quarterly installment due date for the 2006 plan year.

$ **April 15:** Excess elective deferrals and any earnings thereon from the prior year must be distributed by this date.

$ **April 17:** Deadline to establish an IRA for possible deductions in the 2005 calendar year.

For a comprehensive list of upcoming EP Educational Events, visit the Retirement Plans Community web page, select "Plan Sponsor/Employer" and then "Upcoming EP Educational Events." ■

IRS Department of the Treasury Internal Revenue Service Publication 4278 (2-2006) Catalog Number 37968B

Timing is Everything

Some helpful retirement tips for employees from the IRS…

How much can I contribute to my IRA for 2005?

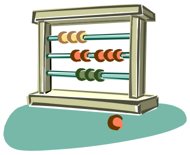
- The lesser of:
  - Your taxable compensation ***or***
  - $4,000 ($4,500 if 50 or older).

When must I make the contribution?

By April 17, 2006 (April 15 falls on a weekend this year).

Is my contribution deductible?

- If it is to a Roth IRA – no.
- If it is to a traditional IRA – maybe.
  (See page 31 of the 2005 Form 1040 Instructions)



For more retirement tips, talk to your employer or visit **www.irs.gov/ep**, select "Plan Participant/ Employee" and click on "Timing is Everything."

IRS Department of the Treasury Internal Revenue Service Publication 4278-B (2-2006) Catalog Number 47879D